THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CAREY M. STITES

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DOCKET NO. 2010-4-G

ANNUAL REVIEW OF
PURCHASED GAS ADJUSTMENT AND GAS
PURCHASING POLICIES OF
PIEDMONT NATURAL GAS COMPANY, INC.

DIRECT TESTIMONY OF CAREY M. STITES
FOR
THE OFFICE OF REGULATORY STAFF
DOCKET NO. 2010-4-G
IN RE: ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT ("PGA") AND GAS PURCHASING POLICIES OF PIEDMONT NATURAL GAS COMPANY, INC.

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Stites. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the Office of Regulatory Staff ("ORS") as the Manager of the Gas Department.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting, from the University of South Carolina. I was employed at that time in the electric and gas utility industry and gained twenty five years' (25) experience in this field. In October 2004, I began my employment with ORS. I have testified on numerous occasions before the Public Service Commission of South Carolina ("Commission") relating to natural gas regulatory matters.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address the purchasing policies of Piedmont Natural Gas Company, Inc. ("Piedmont"), including the hedging program, and the administration of the Gas Cost Recovery Mechanism ("GCRM").

Q. WHAT IS THE REVIEW PERIOD FOR THIS PROCEEDING?

A. The review period is the twelve-month period April 1, 2009 through March 31, 2010.

Q. PLEASE DISCUSS PIEDMONT'S PURCHASING PRACTICES.

A. Piedmont contracts for interstate pipeline transportation capacity, storage service, LNG peaking service and purchases commodity supply from a number of producers and marketers to meet the needs of its firm customers on a peak day, as well as to meet all of its firm and interruptible customers' annual usage requirements. Since it is imperative that the volume of gas required for the firm class of customers be available on the peak day, it would be imprudent for the Company's plans to include the use of interruptible resources for pipeline transportation, storage service, and peak shaving capacity or commodity supply to meet this obligation. Customers, who are dependent upon firm natural gas service for heating, cooking, water heating and other essential needs, expect the natural gas supply to be available. Firm customers have no alternate fuel capability and must have natural gas available 365 days a year.

Q. PLEASE DESCRIBE PIEDMONT'S CAPACITY AND SUPPLY CAPABILITIES FOR THE REVIEW PERIOD.

A. For the Carolinas, Piedmont had firm send out capacity capability available for the Firm Design Day as shown in the testimony of company witness Mr. Williams, Exhibit _ (WCW-4) and supply capability as discussed in the testimony of company witness Mr. Keith Maust. The capacity portfolio to meet this demand included firm transportation contracts on the Transco, Columbia and East Tennessee interstate gas systems. Also, they had storage service from Hardy Storage, Dominion, Columbia Gas, and Transco. In addition, Piedmont had its own two LNG peaking facilities and contracted LNG peaking service available to flow additional natural gas into the system when needed to balance flowing supplies with system load requirements. Piedmont purchased gas supply under a diverse portfolio of contractual arrangements with a number of gas producers and marketers. Under these firm gas supply contracts, Piedmont pays market-based commodity prices tied to indices published in recognized industry publications. Piedmont also purchases gas supplies in the spot market under contract terms of one month or less.

Q. WERE PIEDMONT'S CONTRACTED CAPACITY AND SUPPLY CAPABILITIES SUFFICIENT TO MEET THE REQUIREMENTS OF ITS FIRM CUSTOMERS?

A. Yes. For the fiscal year 2010 winter period (November 2009 - March 2010), the Carolinas projected total design day firm demand, including a five percent reserve margin, was 1,432,131 dekatherms. ORS's review indicates the Company had adequate firm assets, through both capacity and supply contracts, to meet its firm customer's requirements. ORS recommends that the Company continue to monitor its firm capacity and supply capabilities with regard to future growth on the system and the changes being experienced in the natural gas industry.

Q. DID ORS CONCLUDE THAT THE COMPANY ACTED PRUDENTLY IN PURCHASING ITS GAS SUPPLY AND CAPACITY TO MEET THE REQUIREMENTS OF ITS CUSTOMERS?

A. Yes. The Company uses what they refer to as a "best cost" gas purchasing policy. This policy consists of five main components -- price, security, flexibility, deliverability and supplier relations. These components are all interrelated and weighed based on their importance. Piedmont has been very active in purchasing supplies directly in the market and making arrangements through interstate pipelines for capacity for the delivery and storage of these supplies. ORS's observations of Piedmont's gas purchasing policies indicate that Piedmont is continuing its efforts to get the best terms available through negotiations of their contracts. Piedmont has also been very active in FERC proceedings concerning transportation and storage rate changes, as well as other issues concerning the interstate pipeline companies.

Q. PLEASE DISCUSS PIEDMONT'S HEDGING PROGRAM.

A. Piedmont's original hedging program was approved by the Commission on March 26, 2002 in Order No. 2002-223 in Docket No. 2001-410-G. This order allowed the hedging of up to sixty percent (60%) of the Company's annual normalized sales volumes. On May 25, 2005 the Commission issued Order No. 2005-287 in Docket No. 146-G approving limited modifications to the hedging program in order to increase Piedmont's flexibility in making both time-driven and price-driven hedges. On October 11, 2006, the Commission issued Order No. 2006-527 in Docket No. 2006-4-G which modified Piedmont's PGA or GCRM to reflect hedging activity results in the deferred account #253.04 on a monthly basis as requested by ORS. By Petition dated November 25, 2008, Piedmont sought approval to reduce the hedging "horizon" utilized under the Plan from twenty-four (24) months to twelve (12) months. Upon approval of this modification, set forth in Commission Order No. 2009-37, dated February 11, 2009, Piedmont is now approved to hedge gas costs out 12 months in advance of the current period. By Petition dated October 1, 2009, Piedmont requested approval to reduce the percentage range of its normalized annual sales volumes that can be hedged from a range of 30% to 60% down to a range of 22.5% to 45%. On October 15, 2009, this modification was approved in Commission Order No. 2009-728.

Q. WHAT CONCLUSION DID ORS REACH IN ITS REVIEW OF PIEDMONT'S HEDGING PROGRAM?

A. For this annual review period, the Company's hedging program for South Carolina operations resulted in a net cost of $5,435,739 recorded to deferred account # 253.04. Individual cost components of the program are shown in Company witness Robert L. Thornton's Exhibit ____ (RLT-2) and ORS witness

Daniel F. Sullivan's Audit Exhibit ___ (DFS-3). ORS determined that Piedmont operated its hedging activities in compliance with the Commission approved program.

Q. DID ORS REVIEW THE COMPANY'S FORECASTED FUTURE REQUIREMENTS AND THE COMPANY'S STEPS TO MEET THIS DEMAND?

A. Yes. ORS reviewed the Company's forecasted future firm peak design day demand requirements and the measures the Company is taking to ensure the reliability of these supplies and their deliverability. Piedmont has taken a number of steps in securing firm capacity and supply for future demand on its system. These steps include contracting with interstate pipelines for capacity on their systems, acquiring storage capacity, and negotiating contracts with suppliers. Regarding peak shaving capability, we discussed that in Piedmont's 2008 PGA review the Company had planned to construct a new LNG facility with Maximum Daily Withdrawal Quantity (MDWQ) of 125,000 MCF to be available in the 2012-2013 winter heating system. Then on March 9, 2009, Piedmont announced that its previous plans to commence construction of its Robeson Liquefied Natural Gas (LNG) storage facility would be put on hold. On April 15, 2010, the Company announced plans to construct a 133-mile pipeline and new compression facilities to serve Progress Energy Carolinas' new Sutton power generation facility near Wilmington, NC. Piedmont also announced that the Sutton project alleviates the need to pursue further development of its previously announced Robeson Liquefied

Natural Gas (LNG) storage project at this time. The company states that they will stay actively engaged in dialogue with potential service providers and explore a variety of options that may become available to meet those firm requirements, including the possibility of developing the Robeson LNG facility at a later date. Upon review of projections of Piedmont's Carolinas Design Day Firm requirement through 2014 and the assets currently in place to meet this, ORS does not take exception to the Company's announced plans for the Robeson LNG facility. Piedmont has an obligation to maintain adequate supplies at just and reasonable costs to serve its customers. Based on our review of information provided by Piedmont, ORS believes that the Company is prepared to meet this responsibility. For future planning periods, ORS recommends that the Company continue its practice of monitoring its firm transportation, storage, supply and LNG capabilities based upon its forecasted firm demand and in conjunction with the changes continuing to occur in the natural gas industry.

Q. PLEASE DESCRIBE PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM.

A. Piedmont's GCRM is designed to permit the Company to recover the prudently incurred actual cost of gas from its customers. The actual cost of gas consists of two components, a Demand cost of gas and a Commodity cost of gas. The Demand component includes all capacity charges for the transportation and storage of gas. The Commodity cost of gas component is comprised of charges for the volumes of gas purchased. Commodity charges are not associated with the capacity charges for transportation and storage. The GCRM provides that Piedmont establish a Benchmark Commodity Cost of Gas which is the Company's estimate or forecast of the City Gate Delivered Cost of Gas for gas supplies, excluding Demand Charges. The GCRM provides for the recording of the monthly differences between the actual cost of gas purchased and the rate billed to the customer into the Company's Deferred Account No. 253.04. Details of this account are discussed in the testimony of ORS witness Daniel F. Sullivan.

Q. DOES PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM ALLOW FOR ADJUSTMENTS TO THE BENCHMARK COMMODITY COST OF GAS?

A. Yes. The Benchmark Commodity Cost of Gas may be adjusted to recognize changes in this billing factor for the amount to be recovered. These requests are filed with ORS for review and the Commission for approval. The GCRM also allows for the same type adjustment for the Demand Cost of Gas Component, although the Demand Component does not change as frequently as the Commodity Cost of Gas Component.

Q. WHAT IS THE CURRENT BENCHMARK COST OF GAS INCLUDED IN THE COMPANY'S RATES?

A. The current benchmark commodity cost of gas, GCRM - 128, included in the company's rates is $5.60 per dekatherm which became effective with the first billing cycle of April, 2010. ORS does not recommend any change to the benchmark cost of gas at this time.

Q. DID THE COMPANY MAKE ANY CHANGES TO ITS GCRM TARIFF DURING THE REVIEW PERIOD?

A. Yes. In Order No. 2010-250, the Commission approved the Company's request to change the manner by which it calculates and records lost and unaccounted for (LAUF) gas costs which eliminated the need for an annual true-up of LAUF volumes. Also, the new GCRM tariff contains a provision to allow the LAUF percentage calculation to be changed in the Rate Stabilization Act (RSA) proceeding and not only in the Company's last general rate case.

Q. DID THE COMPANY ADMINISTER ITS GCRM DURING THE REVIEW PERIOD IN ACCORDANCE WITH THE COMMISSION APPROVED TARIFF?

A. It is the opinion of ORS that it did.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.